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SUBJECT: KAZAKHSTAN: CONNECTIONS KEY TO SMALL BUSINESS SUCCESS

¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: Kazakhstan is home to a number of government-sponsored initiatives to improve conditions for small and medium enterprises. However, such support from the highest levels of government still has little impact on the daily reality of business operations, which require the extensive utilization of private networks of connections as well as bribes. END SUMMARY.

PRESIDENT CALLS FOR INCREASED SUPPORT FOR SME'S

¶3. (U) Improving the business climate for small and medium enterprises (SMEs) remains a publicly expressed priority for the Kazakhstani government. In his December 16 Kazakhstani Independence Day address, President Nazarbayev noted that more than 1.8 million people work in SMEs in Kazakhstan, and said that Kazakhstan "must significantly increase the share of small and medium enterprise in the structure of the economy," bringing it to the level moderately developed European countries. He argued that "for every Kazakhstani there must be the possibility to take on new ventures, open new businesses, or expand their sphere of operations."

¶4. (U) Nazarbayev promised that the government will increase support for SMEs as one of its principal steps to mitigate the effects of the global financial crisis. This support will apparently include several components. In 2009, the Samruk-Kazyna National Welfare Fund will distribute \$1 billion to commercial banks in support of SME activity, 70% of which will be for existing businesses, and 30% for new enterprises, with no loans exceeding \$5 million. The government will guarantee interest rates at no more than 14% for SMEs. Samruk-Kazyna will also work to reduce administrative barriers to trade and entrepreneurship, and develop a micro-credit program designated specifically for the economic development of rural territories.

PROCUREMENT LAW TO NURTURE SMALL BUSINESS

¶5. (SBU) In the latter half of 2008, the government of Kazakhstan enacted several laws designed to nurture economic diversification and increase opportunities for domestic SMEs to find a role in the extractive sector. The new Law on Government Procurement was approved in November 2008 and is designed to make government

procurement procedures more open and transparent. More specifically, it also requires foreign and domestic companies to maintain unspecified percentages of local content. This is expected to benefit Kazakhstani small and medium businesses by granting them access to approximately \$9-10 billion in business annually. In a bid to promote e-commerce, the law also includes plans to introduce a centralized portal by 2010 through which SMEs can more readily participate in government contract bidding.

#### DOING BUSINESS IN ASTANA MEANS HAVING CONNECTIONS

**¶6.** (SBU) While the government continues to seek out ways to support the growth and development of SMEs, its bureaucrats continue to reap the officially illegal but culturally accepted benefits of their authoritative positions over Kazakhstan's new entrepreneurs. According to one former Embassy employee, who has since moved on to open a small restaurant in the heart of new Astana, the greatest secret to owning and operating a successful business in Astana is having the right friends in the right places. Almost every facet of starting and operating a business depends on these connections, she maintained. According to the former Embassy employee, those who intend to open a small enterprise in Astana must have a "check list" of permissions signed off by all major city administrative departments. Once completed, it is submitted to the City Architecture Department for final approval. She maintained that she never would have been able to complete this process without an extensive network of friends and contacts. However, she noted, these friends do not normally provide their assistance for free. For example, getting necessary signatures from the city sanitation and fire departments (among others) meant identifying and coming to an "agreement" with the right people. (COMMENT: This was clearly a thinly veiled reference to bribery. END COMMENT.) Once an

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agreement has been reached, business owners are promised freedom from excessive inspections and requirements, with the understanding that this arrangement will continue in the future for nominal fees. This arrangement also tends to include a provision that will shield them from other possible inspections or disruptions. (COMMENT: This arrangement is commonly referred to as paying for the "krisha" or roof. END COMMENT.) In her own arrangements, because she owns a restaurant, she must also be prepared to regularly serve free lunches to representatives of the state bodies with whom she has made agreements. She reports that with the support of these new and old friends, she has managed to avoid any inspection since April 2008 from any government agencies including the Financial Police and the Tax Committee.

**¶7.** (SBU) Aside from the complexities of registration, there were other difficulties which she has successfully surmounted. Getting credit is not cheap, she said. However, she was able to open a line of credit with KazKommertsBank at what she said was a very good 18% interest rate. She also said that she had searched for an appropriate location for unexpectedly long period of time, noting that despite the appearances of extensive growth, viable commercial real estate is in very short supply in Astana. Once a suitable location had been found, she spent nearly two months navigating the city bureaucracy to get necessary permits from the City Architectural Department to renovate the premises. She was lucky enough to have a "friend" who works for the Tax Committee and works under the table as a bookkeeper for the restaurant, ensuring that tax documents are both properly prepared and efficiently filed.

#### HARSH CLIMATE IN ASTANA

**¶8.** (SBU) There are many challenges to doing business in Astana, the least of which comes from being located at the end of one of the world's longest supply chains. For the former Embassy employee, simply finding good equipment and dishes for the restaurant was a challenge. Her store-front sign needed to be approved by city authorities, which afforded more opportunities to make friends, and they are constantly encouraged to appropriately decorate for holiday seasons, plant flowers, or keep their store front spotless. (COMMENT: Her restaurant is located on the main strip near many of the main government ministry buildings, in a highly visible showcase part of the new capital city. END COMMENT.) She also noted that it

has been extremely difficult to find and retain qualified kitchen staff.

¶19. (SBU) The challenges of running a small successful restaurant were echoed by Vice Minister of Industry and Trade Zhanar Aitzhanova during a December 24 meeting with the Ambassador. Aitzhanova confidently pointed out that the finest restaurants in Astana tend to be owned by people "with other sources of revenue" and need not concern themselves with successful business models. In fact, most of the extremely expensive high-end restaurants (which comprise about 50% of all restaurants) sit empty most evenings.

#### FRANCHISES BEGIN TO BRAVE ASTANA

¶10. (SBU) Unlike most places in the world, there continues to be a noticeable lack of western franchise operations in Kazakhstan, with one major exception. One December 5, a Friday's (TGIF) restaurant celebrated its grand opening in Astana. The Astana Friday's is supervised from Moscow by the Russian-owned Rostik group, and the restaurant managers surmise that the owners are very well-connected in Kazakhstan. They did reportedly have problems initially with the Ministry of Justice (MOJ) when attempting to register the business because of the English name, but have since reported few problems with authorities. (NOTE: The MOJ initially insisted that the restaurant be given the Kazakh name Allah Zhaksy - Bugin Zhuma or "God is Great - Today is Friday" until they were persuaded of the necessary inclusion of the TGIF trademark. END NOTE.) However, TGIF was subject to one inspection raid prior to opening which indicated that its connections may be tested. In a November 20 meeting with the DCM, TGIF managers described the raid by a combined group of inspectors representing Financial Police, the Tax Committee, and the Procurator's Office that they believe to be the

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result of a complaint lodged with MOJ by a competitor. (NOTE: A moratorium on random inspections has been in effect since January 1, 2008, except in the event that an alleged licensing violation is reported to authorities. END NOTE.) TGIF managers noted, however, that once inspectors realized that the business had not even opened, they had no real grounds for the clearly unfounded inspection. Despite their ability to avoid conflict, TGIF managers agreed that Kazakhstani regulations are likely designed such that a violation can always be detected, but were quick to point out that the system of connections also allows for the quick resolution of potential problems. TGIF has also been hampered by the long supply chain and the expense of importing goods. Despite \$20 hamburgers, TGIF could not obtain an egg timer for cooking their French fries. Managers, all of whom happen to be young and female, also noted that sexism in male-dominated Kazakhstani society remains a constant challenge in operating a business.

#### BUREAUCRACY AND CORRUPTION CHALLENGE PROFITABILITY

¶11. (SBU) According to the President of the American Chamber of Commerce in Kazakhstan, Kenneth Mack, there are many legitimate business opportunities in Kazakhstan, but the system is entirely based on connections, and a lot of demands for payoffs from government officials. Acknowledging a lack of Western business, particularly SMEs, Mack said in a December 30 meeting with Econoff that given Kazakhstan's physical isolation, the relatively small size of the domestic market, and a lack of infrastructure in the country that complicates the delivery of supplies and services, the margin of profit is very small. He concluded that "if you add bureaucracy and corruption, you remove the profitability altogether." "Generally speaking" he said, "there is no room for a small business without connections, and it is not at all safe for a U.S. business without a well-connected local partner."

¶12. (SBU) COMMENT: The World Bank recently ranked Kazakhstan at 70 out of 181 countries for the ease of doing business. Kazakhstan was also ranked 145 out of 180 countries in Transparency International's perceptions of corruption index. While Kazakhstan continues to address the need to improve the business climate for SMEs, and the political will for the financing and development of successful entrepreneurship remains high, the simple fact is that for now, patronage and connections above all else remain the key to operating

a successful small- or medium-sized business.

¶13. (SBU) COMMENT CONTINUED: The Public Private Economic Partnership Initiative (PPEPI) provides a vehicle through which SMEs, both foreign and Kazakhstani, could directly address their realities to the central government. Currently, even the largest firms will not publicly raise corruption since they fear retaliation. The PPEPI June launching was remarkable in that the Prime Minister held an "interactive session" during which he listened to constructive but blunt criticism. Until the highest levels of the Kazakhstani leadership impose an anticorruption regime on the mid-level bureaucrats, investment in Kazakhstan will be limited to large firms able to deploy battalions of lawyers. END COMMENT.

HOAGLAND